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## National Security Reviews of Foreign Investment



Statement of
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Before the
Subcommittee on Commerce, Consumer
Protection and Competitiveness
House Committee on Energy and Commerce
House of Representatives

Madam Chairwoman and Members of the Subcommittee:

I am pleased to testify today before this Subcommittee on some of the issues raised in our work on the Administration's national security reviews of proposed foreign investments.

As you know, the 1988 Exon-Florio Amendment to the Defense Production Act gave the President authority to investigate and block or suspend foreign investments that threaten to impair national security. This authority lapsed as of October 20, 1990, with the expiration of the Defense Production Act.

To assist the Subcommittee in considering the renewal of the Exon-Florio Amendment authority, I will describe the results of our work regarding the following issues: (1) the nature of the administration's authority to review and if necessary block foreign investments during this present period in which the Exon-Florio authority has lapsed, (2) the reasons why it has taken the administration more than a year to implement a presidential divestiture order in the one case that the President ordered to be blocked under the Exon-Florio provision, (3) the types of difficulties experienced by the interagency Committee on Foreign Investment in the United States (known as CFIUS) in analyzing specific investments under the Exon-Florio provision, and (4) the larger public policy questions.

## PRESIDENT'S BLOCKING AUTHORITY

CFIUS[1] was created by executive order in May 1975, and its broad authority to review foreign investment in the United States predates the Exon-Florio Amendment. The Exon-Florio Amendment gave the President new authority to block or suspend foreign investments threatening to impair national security. It also set specific maximum time frames for the review of foreign investments, permitting a maximum of 90 days, including a 30-day initial review period to determine whether to initiate an investigation, then 45 days to complete such an investigation, and a final 15 days for the President to act.

Shortly after the lapse of the Exon-Florio provision, CFIUS announced that it would continue to receive voluntary notices of proposed transactions under its pre-existing authority. According to CFIUS staff, parties to foreign investments have continued to submit voluntary notifications of transactions to CFIUS, and CFIUS has continued to review such transactions. CFIUS notes that it has continued to use Exon-Florio criteria in these reviews because it

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[1]CFIUS is an interagency committee chaired by the Treasury Department. Its members are the Secretaries of Treasury, State, Defense, and Commerce; the Attorney General; the U.S. Trade Representative; the Chairman of the Council of Economic Advisers; and the Director of the Office of Management and Budget.

understands that the expiration of the Defense Production Act arose from circumstances unrelated to Exon-Florio and because it expects that Exon-Florio will be reauthorized later in 1991.

During this lapse of authority, one investment case did move into the full investigation stage and proceeded to the final, presidential-decision stage. This case involved the proposed investment by Fanuc, Ltd., of Japan in the U.S. firm Moore Special Tool Co., Inc., which supplies the Energy Department with precision machine tools used in making nuclear weapons. In this case CFIUS did not adhere precisely to the time frames set by Exon-Florio for an investigation, and the President also did not make a decision on the case within the specified 15-day time frame. One of the reasons Fanuc gave for withdrawing its purchase offer was uncertainty about the timing of the CFIUS process.

According to CFIUS staff, they did not consider the lapse of the President's blocking authority to have been a constraint on their consideration of the case and their presentation of findings to the President. They said that CFIUS is operating on the expectation that Exon-Florio will be renewed and that, in any case where a Presidential blocking decision is being considered, it will advise the investment parties to postpone completing the transaction. Otherwise, the foreign investor would risk undergoing all the disruptions that a later presidential divestiture order would entail.

We note that the President continues to have authority to block a foreign acquisition of a U.S. firm under the International Emergency Economic Powers Act (50 U.S.C. 1701-06), if he declares a national emergency in response to an unusual and extraordinary threat to the U.S. national security, foreign policy, or economy. This law has been used in recent years as legal authority supporting the continuation of regulations administering export controls during periods of lapses in the Export Administration Act.

## IMPLEMENTING PRESIDENTIAL DIVESTITURE ORDERS

The only CFIUS case so far in which the President used his Exon-Florio authority to block a foreign investment entailed a presidential order requiring divestiture, because the parties to the investment completed the transaction before CFIUS had concluded its consideration of the case. This case involved the acquisition by a People's Republic of China firm, the China National Aero-Technology Import and Export Corp. (CATIC), of the U.S. aerospace parts firm MAMCO Manufacturing, Inc.

To block this investment, the President issued an order on February 1, 1990, requiring CATIC to divest its control of MAMCO. This divestiture order required CATIC to sell MAMCO, but did not put MAMCO's previous U.S. owners under any obligation to buy it back, since the transaction had been completed. Completing the

transaction before CFIUS had concluded its investigation was not prohibited under the Exon-Florio Amendment. The disruptions involved in divestiture fall clearly on the foreign buyer.

The President's February 1, 1990, order required CATIC and its subsidiaries and affiliates to divest all of their interest in MAMCO and its assets by May 1, 1990, and provided for an extension of this date for a period not to exceed 3 months. We were told that no specific regulations or procedures are in place governing how such a divestiture would proceed.

During the summer of 1990, a potential buyer for MAMCO was identified and negotiations took place. However, by early September, it appeared that the potential buyer would be unable to close on the transaction.

According to Treasury staff, by August 1990 the administration had established a trusteeship arrangement whereby all MAMCO stock was put in an irrevocable trust. The trustees then assumed all authority to make business decisions regarding MAMCO. One effect of this arrangement was to remove CATIC's ability to reject reasonable purchase offers. Under this arrangement the U.S. trustees hired an investment banking firm to help find a buyer for MAMCO. At present, another prospective buyer has been identified, and negotiations are taking place between the buyer and the trustees.

Treasury staff noted that the time it has taken to find a buyer for MAMCO should be considered in light of the overall slowdown in the U.S. economy and the general complexities of finalizing business transactions.

## DIFFICULTIES IN APPLYING EXON-FLORIO CRITERIA

Now let me turn to the difficulties that have been experienced in applying the Exon-Florio criteria.

The Exon-Florio Amendment established 3 key requirements for analyzing proposed foreign investments: 1) There must be a link to national security, 2) there must be a finding that credible evidence exists that the foreign interest might take action that threatens to impair U.S. security, and 3) there must be a finding that provisions of law, other than the International Emergency Economic Powers Act, do not provide adequate authority to protect the national security.

CFIUS' focus has been on developing information, on a case by case basis, to meet all 3 specific requirements. CFIUS has not functioned as a means of assessing broader concerns about foreign ownership of the U.S. defense industrial base.

## Defining national security

CFIUS must first consider whether a proposed investment is linked to national security. The Exon-Florio Amendment did not define "national security," but the accompanying conference report noted that the phrase was to be interpreted broadly and without limitation to particular industries. The proposed implementing regulations, which were issued in July 1989, also did not define national security.

Important concerns have arisen in public debate about how to define the industries and technologies that are national security related. A narrow definition would include firms that do the majority of their business with the Department of Defense (DOD) or as subcontractors to DOD prime contractors. A broader definition would include industries and firms whose business is driven by the civilian commercial sector but, because of their leading edge technologies, are important to overall defense technology leadership.

In our review last year of CFIUS cases considered under Exon-Florio, we did not find evidence that the absence of a specific

definition of national security affected CFIUS' ability to investigate investments.[2]

The credible evidence criterion

The second key element of a CFIUS decision involves determining whether there is credible evidence that the foreign interest might take action that threatens to impair the national security. Addressing this question implicitly calls for an examination of the past behavior of the acquiring firm. To learn whether there may be such "credible evidence," the Departments of Commerce, Defense, and State search their export control records for licensing and enforcement information. The intelligence agencies can also be called on to check, for example, for any known unauthorized technology transfers.

The past CFIUS cases indicate that it is inherently more difficult for a CFIUS agency to argue that foreign firms from allied countries may threaten national security. It should be remembered that the one case the President blocked involved an investment from the People's Republic of China.

I would also like to point out that it is unclear as to whether anticompetitive behavior on the part of the foreign firm would

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[2]Foreign Investment: Analyzing National Security Concerns, (GAO/NSIAD-90-94, March 29, 1990)

constitute the type of threat to national security envisioned under the credible evidence provision. Examples of such types of anti-competitive behavior might be withholding from U.S. competitor firms supplies of the most technologically advanced components or engaging in cartel-like practices to damage U.S. competitors.

Inadequacy of other U.S. laws

The third key element requires making a finding that other U.S. laws are inadequate to protect the national security. In past cases, such laws as the Export Administration Act, the Defense Production Act, and the antitrust laws have been considered by CFIUS in this regard.

We note that none of these laws can protect against a foreign-owned firm's decision to close down a U.S. factory or to change the firm's product line or research direction.

Other difficulties

Concerns have been raised about the adequacy of data available to CFIUS to evaluate proposed investments. CFIUS evaluates investments on a case-by-case basis and is able to gather extensive information about the firms involved. The more difficult questions arising in past cases were those requiring judgments about the likely future behavior of foreign investors. These required

assessments of foreign investor intentions regarding technology transfer, continued supply to DOD or its contractors, and use of any commercial advantages gained through the investment.

## LARGER PUBLIC POLICY QUESTIONS

CFIUS determinations relate only to the specific parties to the transaction under review. CFIUS does not perform analyses of foreign investment by industry sector, nor does it examine other larger questions which have arisen in public debate. These questions include (1) how much of the defense industrial base has been acquired by foreign-owned firms, (2) which industry sectors, technologies, or types of firms, if any, should be preserved for U.S. ownership, (3) why some U.S. companies have found it desirable to discontinue operations in certain high technology sectors, or (4) how to assess the direction and effects of technology transfers accompanying foreign acquisitions.

These questions need to be addressed at a higher policy-making level and in a broader context than the case-by-case approach presently afforded by CFIUS.

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This concludes my statement, Madam Chairwoman. I will be happy to try to answer any questions the Subcommittee may have.